COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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BOSTON GAS COMPANY d/b/a	)	
KEYSPAN ENERGY DELIVERY NEW ENGLAND	)	**D.T.E. 03 - 40**
	)	

REPLY BRIEF OF THE

MASSACHUSETTS DIVISION OF ENERGY RESOURCES

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I. INTRODUCTION

The Massachusetts Division of Energy Resources ("DOER") incorporates, as if fully set forth herein, the recitation of history, proceedings, statement of issues, arguments, and conclusions set forth in its Initial Brief filed on August 29, 2003.

On September 10, 2003, the Boston Gas Company d/b/a Keyspan Energy Delivery New England ("Boston Gas" or the "Company") filed with the Department of Telecommunications and Energy (the "Department") its Initial Brief in this proceeding.

As a threshold matter, on page 178 of its Initial Brief, the Company states that it "will not respond to all of the issues raised by the DOER and the Attorney General in this initial brief and will address remaining issues in reply." This attempt by the Company to invent and reserve a non-existent right has no legal foundation and should be expressly rejected by the Department. Should the Department, on its own, identify issues for which it desires additional information, the Department should re-open and schedule hearings on those topics. To the extent that such issues are applicable to establishing a performance based rate ("PBR") plan for the Company, the Department should sever the PBR issue from the base rate proceeding and schedule further proceedings concerning PBR separately from any final Order addressing base rates.

II. ISSUES

The Company's Brief Materially Misstates DOER's Conclusions Concerning the Company's Poor Performance

DOER proffered an alternative PBR formulation to that proposed by the Company which, in addition to being simpler to implement and oversee and providing a higher degree of precision and accuracy, responded to the Company's demonstrably poor cost performance over the term of its initial PBR plan.

It is DOER's conclusions about the Company's poor performance that the Company has misstated in its Brief. The fact of the Company's poor cost performance is so material to any going-forward analysis of incentive regulation that DOER must respond to the Company's misstatements.

The Company states, at page 173 of its Brief that:

> **DOER acknowledged** [emphasis added] that the Company has been a relatively good cost performer over the 1993 – 2000 period and that it will be "difficult for the Company to equal or exceed the productivity gains that were alleged to have happened during the first PBR plan" (id. at 24).[1]

DOER simply did not say this. DOER made it absolutely clear that, based on the Company's own data, any objective assessment would inexorably conclude that the Company's cost performance was poor and that any PBR proposal predicated on a claim of good cost performance would be fundamentally flawed:

> [t]he Company's productivity has suffered significantly between 1990 – 2001. Of greater significance is the fact that, except for a nominal

1 Had the Company accurately replicated DOER's position, it would have been obvious that the only party who proffered the claim that the Company was a good cost performer, contrary to the Company's own data; Exh. RR – DOER – 1; was Boston Gas. DOER Brief at pages 23 – 24.

increase in 1998, Company productivity worsened during the time the current PBR Plan was in effect, as illustrated in Table 1.[2]

The Company's PBR proposal is predicated on its claim of superior cost performance. In fact, as set forth in DOER's Initial Brief, the reverse is true and any PBR proposal based upon the Company's claim of superior cost performance simply will not meet the Department's goals and objectives for incentive regulation.

DOER Used the Data Provided by the Company to Perform Its TFP Analysis Which Unequivocally Demonstrates the Company's Poor Performance

The Company's assertion, at page 178 of its Initial Brief, that DOER employed incomplete or misleading data, if correct, serves only as an indictment of the accuracy of the Company's own information. As set forth in DOER's Brief, pages 14 – 16, DOER's analysis relies exclusively upon the information provided by Boston Gas in its filing to the Department and elicited by DOER and the Department through record requests during the hearings. If there is any inaccuracy to be found here, it is the result of the Company's failure to provide complete and accurate information to the Department and to the Intervenors. It is also important to point out that, even if the Company data provides less than a complete picture, it unequivocally shows that the Company's productivity continues to worsen, albeit at a slightly less (-0.76% v. –0.93%) dramatic rate

The Company asserts, at page 179 of its Initial Brief, that its productivity would have been greater had output growth kept pace with the Company's input

2 DOER Brief at pages 14 – 15.

growth. This assertion is mystifying. The Company fails to explain why the change in input usage should not be related to changes in outputs. The goal of a well-crafted PBR plan should be to mimic market forces, whereby firms adjust their input usage based on demand trends or forecasts.

For example, excluding the year 2001 as an outlier, the average annual growth rate in the output quantity index over the 1999 – 2001 period was 0.34%, compared to 1.35% for the input quantity index. It is clear that the prior PBR plan failed to provide sufficient incentives for Boston Gas to adjust its input consumption to this apparent trend in reduced sales.

The Company's Objections to the Use of the Producer Price Index are Without Merit

The Company, at pages 182 – 185 of its Initial Brief, articulates a series of reasons that it believes makes the use of the Producer Price Index for Natural Gas (PPI-NG), as recommended by DOER,[3] "problematic."

The PPI-NG, similar to the Gross Domestic Product Price Index (GDP-PI), is indeed an output-based, national index. The Company's proposed PBR Plan does not adjust the GDP-PI; it adjusts the X-Factor. DOER believes that such a one-time adjustment over the term of the PBR Plan does little to capture the relationship between inputs and outputs or to take into account regional differences for the natural gas industry.

The Company claims that there may be adjustments and changes to the PPI-NG , which could render the index "unavailable" in the future or change the

3 See DOER Brief at pages 26 – 29.

nature of historical PPI-NG data (id. at 183). DOER contends that such potential changes are not idiosyncratic to the PPI-NG but are endemic among price indexes in general.

For example, the National Income and Product Accounts (NIPAs) upon which the GDP-PI is based have been revised a total of twelve (12) times, with the latest revisions occurring within four years of each other. As part of its last revision, the NIPAs were converted to the North American Industry Classification System (NAICS), heretofore the 1987 Standard Industrial Classification (SIC) system. The Company's argument therefore, is without merit, as it is a given that revisions ordinarily occur in index preparation and calculation.

The Company continues its litany of objections by claiming that the PPI-NG numbers are "suspect" and it is unclear why unbundled gas distribution rates and their corresponding input prices would fall by 5.45% in one year (id. at 184). While it may be unclear to Boston Gas, it is axiomatic that such price changes can and do occur, as illustrated by the Company's input quantity index for 1998, which showed a similar decline from 1997 levels.

Finally, the Company claims that the volatility in the PPI-NG is problematic and contrary to the goals and objectives of incentive regulation. DOER believes that the PPI-NG demonstrates an acceptable level of volatility and is much more reflective of the realities of the natural gas industry than the GDP-PI. While the GDP-PI has historically been more stable, DOER submits that it is not realistic to assume that distribution company input prices should never go down from year to year.[4]

The Clawback Mechanism is Not Complex or Difficult to Implement

As a final argument in response to DOER's indexing proposal, Boston Gas asserts, without elaboration, that DOER's clawback mechanism will "involve considerable implementation difficulties, will make regulation more rather than less complex, and will increase regulatory burdens (id. at 182)."

DOER is hard pressed to understand this conclusion. DOER's alternative PBR formulation is significantly simpler and more straight-forward than the Company's proposal. The clawback mechanism, which is a critical component of DOER's proposal, functions so as to ensure returns that rightfully belong to ratepayers actually go back to ratepayers. It requires a comparison of the Company's average, annual, productivity change over the term of the PBR plan to a benchmark. This concept is neither new to the Department nor complex to implement.[5]

Cast-Off Rates Must Be Correct if PBR is To Accomplish the Department's Goals Going Forward

The PBR model before the Department in this proceeding is a price cap model, which relies, in the first instance, upon setting correct cast-off rates for the Company. The cast-off rates[6] form the basis of the annual increases driven by inflation or the annual decreases (which have never been implemented by

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4 See **ATTACHMENT A**. The last time the GDP-PI chain-type price index fell from one year to the next was in 1939.

5 DOER Brief at pages 30 – 31.

6 Cast-off rates are also referred to as the "initial price cap," and "distribution rates." No matter how characterized, the importance of accurately establishing those rates cannot be over-stated. See Boston

Boston Gas, despite its claims about superior performance) resulting from productivity improvements. It is, therefore, critical to the success of the PBR plan and to ensuring just and reasonable rates going forward, that the cast-off rates established by the Department accurately reflect the Company's true revenue requirements.

The Company, as demonstrated throughout the hearings and as elaborated on by the Attorney General in his Initial Brief, has proposed an unrepresentative test year and has failed to provide adequate support for its proposed revenue requirements.[7]

Chapter 164, § 94 obligates the Department to set just and reasonable rates. Fulfilling that obligation is not possible unless the cast-off rates are correct and accurate. DOER recommends that the Department fully scrutinize the evidence, and particularly the inconsistencies in the evidence, presented by the Company and, if need be, require the submission of any other information as may be required to ensure that the cast-off rates that will result, going forward over the course of any PBR plan, are just and reasonable.

Gas Company v. Department of Telecommunications and Energy, 436 Mass. 233, 235 (2002).
7 Attorney General Brief at pages 19 – 92.

III. CONCLUSION

DOER respectfully requests that the Department, in addition to acting on the recommendations proffered in its Initial Brief:

Proscribe Boston Gas from raising issues on Reply which were required to be raised here and that cannot be raised by invoking a reservation to a non-existent right;

If determined necessary to consider and craft an alternative PBR plan, act on the Attorney General's Motion and sever the PBR component of the proceedings from the base rate proceedings; and

Make such further determinations as the Department deems necessary to ensure the implementation of just and reasonable rates by Boston Gas.

Respectfully submitted,

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